

# CONTROLLER STEVE WESTLY

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## Westly Proposes Reforming NYSE “Trade-Through” Rule

The following is the text of a January 30<sup>th</sup> letter sent by California State Controller Steve Westly to SEC Chairman William Donaldson

Dear Mr. Donaldson:

As California’s elected chief financial officer and a board member of the state’s pension funds CalPERS and CalSTRS, I appreciate your ongoing efforts to reform the New York Stock Exchange. Still, as I discussed with interim Chairman John Reed, more action is needed, especially to revamp the NYSE’s business model.

An important starting point is to reform the trade-through provisions of the Intermarket Trading System (“ITS”). The apparent success of the *de minimus* exemption for exchange-traded funds (“ETFs”) indicates that change is not only possible, but also desirable. Accordingly, I urge you to expand the trial of the three-cent *de minimus* exemption to all listed stocks for at least a year and to make the exemption permanent if the trial is successful.

Reforming the ITS trade-through provision is a sensible step:

1. **The trade-through provision is obsolete.** As the SEC noted in establishing the exemption for ETFs, “these rules were designed... when the order routing and execution facilities of markets were much slower, intermarket competition less keen, and the minimum quote increment for exchange-listed securities was 1/8 of a dollar.”<sup>1</sup> With changes due to decimalization and electronic technology, the trade-through rule may actually hinder market activity.
2. **Reforming trade-through will improve investor freedom.** A *de minimus* exemption enables securities buyers and sellers to better choose how they prefer to execute a trade. The exemption allows them to consider factors that may be as important or even more important than the “best advertised price” proviso of the trade-through rule, including quality and speed of execution.
3. **The *de minimus* exemption preserves investor protections.** As the SEC stated in establishing the current exemption for ETFs, a three-cent exemption “will, on balance, provide investors increased liquidity and increased choice of execution venues while limiting the possibility that investors will receive significantly inferior prices.”<sup>2</sup> In an era of decimal pricing and an educated marketplace, even individual investors are unlikely to mind trading off a penny or two in exchange for a more competitive market and better execution.

<sup>1</sup> “Securities Exchange Act of 1934, Release No. 46428”, Securities and Exchange Commission, May 28, 2002.

<sup>2</sup> Ibid.

That the SEC chose to extend the initial exemption for ETFs suggests that the trial reform of the trade-through rule has shown success. Expanding the trial to all listed stock for a finite time represents a low-risk path to broader reform of the NYSE. If such a trial proves successful in fostering investor choice without undermining protections, I would urge the SEC to make the *de minimus* exemption permanent. The SEC should then explore options for further adjusting the trade-through provisions to benefit all investors who do business with the world's largest exchange.

I plan to ask the boards and staff of CalPERS and CalSTRS to join me in advocating expansion of the trial *de minimus* exemption to include all listed stocks. I am happy to work with you and the leadership of the NYSE to pursue this in the most appropriate way.

Thank you for your attention to this matter.

Sincerely,

STEVE WESTLY  
California State Controller

cc: John Reed, Interim Chairman, New York Stock Exchange  
John Thain, Chief Executive Officer, New York Stock Exchange

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